

DEPARTMENT OF STATE REVENUE**LETTER OF FINDINGS NUMBER: 98-0075****Use Tax****For Years 1994 through 1996**

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ISSUES**I. Use Tax – Imposition of use tax on various pieces of equipment purchased by the taxpayer.**

Authority: Ind. Code § 6-2.5-3-2;
Ind. Admin. Code tit. 45, r. 2.2-5-10;
Indianapolis Fruit Co. v. Department of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998).

The taxpayer protests the imposition of use tax on its purchases of various pieces of equipment.

II. Tax Administration – Penalty.

Authority: Ind. Code § 6-8.1-10-2.1;
Ind. Admin. Code tit. 45, r. 15-11-2.

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is an Indiana corporation in the business of manufacturing and selling ice. The ice is manufactured in one building, moved to another room where it is bagged, and finally moved into a prefabricated building known as the Leer building. The ice is kept in the Leer building until it is transported and delivered to various retailers throughout southern Indiana.

A sales and use tax audit was completed on November 24, 1997. The taxpayer timely filed a protest and a hearing was held on July 18, 2000. Additional facts will be provided as necessary.

I. Use Tax – Imposition of use tax on various pieces of equipment purchased by the taxpayer.

DISCUSSION

The taxpayer protests the imposition of use tax on its purchases of various pieces of equipment during the audit period. The taxpayer purchased the Leer building and several pieces of equipment associated with the building. The associated equipment consists of a bagging room wall; slant doors, hinges, hinge cover, chains, and chainstop; freezer units (compressors) and parts for those units; and a freezer addition. Sales tax was not paid on the purchases of the Leer building and equipment, nor was use tax remitted on these purchases.

The taxpayer also purchased several merchandisers and did not pay sales tax at the time of purchase, nor was use tax remitted. Some merchandisers were leased by the taxpayer and no sales or use tax was remitted on those transactions either. A merchandiser is a refrigerated storage unit, a freezer, where ice is stored until it is purchased by customers. The taxpayer manufactures the ice and delivers it to the merchandiser units at the retail locations.

“An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.” Ind. Code § 6-2.5-3-2(a).

The taxpayer argues that the Leer building and associated equipment and the merchandisers are manufacturing machinery, tools, or equipment and qualify for exemption under Ind. Admin. Code tit. 45, r. 2.2-5-10(c). That regulation states:

Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.

The taxpayer maintains that the purchases of the Leer building and the equipment qualify for the manufacturing exemption. After the ice is produced, it is moved to the bagging room. The temperature in the bagging room is approximately 50 degrees Fahrenheit. After bagging, the ice is moved to the Leer building where the temperature is kept at 20 degrees Fahrenheit, or below. The temperature in the merchandisers is also kept at 20 degrees or below. The taxpayer states that the Leer building and the merchandisers, because of their lower temperatures, continue to act upon the ice and that this constitutes a continuation of the refining process. The taxpayer makes a distinction between what it terms the “soft ice” that goes into the Leer building subsequent to bagging and the “hard ice” it becomes after exposure to the low temperature in the Leer building.

The term “refining” is defined in the same regulation cited by the taxpayer. “Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change.” Ind. Admin. Code tit. 45, r. 2.2-5-10(k). The taxpayer produces ice which is then put in the Leer building for storage. Of course the Leer building is refrigerated or the ice would not be ice for very long. The transformation from water to ice, induced by the taxpayer, has already taken place before the ice enters the Leer building. It is ice going in and it is ice when it is removed for transport to retailers. Likewise it is ice the taxpayer delivers to the merchandisers and it remains ice while being stored in the merchandisers. The Leer building and the merchandisers act to store the ice at temperatures that prevent the ice from melting.

During the hearing, the taxpayer indicated that it was also relying on Indianapolis Fruit Co. v. Department of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998). In that case, the court held that items integral and essential to a banana ripening process were exempt from sales and use tax. Id. at 1385. The court found that the petitioner’s efforts resulted in the transformation of the bananas from an unmarketable product to a marketable one. Id. In the same case, the court found that the petitioner was not entitled to a tax exemption for items associated with the process of ripening tomatoes since the tomatoes ripened on their own without the petitioner’s efforts.

Although the taxpayer did not elaborate on how its situation is similar to the one in Indianapolis Fruit, the taxpayer’s case is distinguishable from the one in Indianapolis Fruit. The banana ripening process in Indianapolis Fruit was actively induced by the petitioner and those efforts transformed an unmarketable product to a marketable one. While the taxpayer processes water into ice, this process is completed by the time the bagged ice enters the Leer building or is delivered to the merchandisers.

Tangible personal property used in or for the purpose of storing
raw material, work in process, semi-finished or finished goods
is subject to tax except for temporary storage equipment necessary
for moving materials being processed or refined from one production
step to another.

Storage facilities or containers for finished goods after completion of the production process are subject to tax.

Ind. Admin. Code tit. 45, r. 2.2-5-10(e)(2).

The Leer Building and the merchandisers are storage facilities for the taxpayer's finished goods, ice, and are subject to tax. Since the Leer building itself is taxable and no production occurs in the building, purchases of items associated with the building are also subject to tax.

FINDING

The taxpayer's protest is denied regarding the purchase of the Leer building and equipment. The taxpayer's protest is denied regarding the purchase and lease of the merchandisers.

II. Tax Administration – Penalty.

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. The Department imposed the negligence penalty due to the taxpayer's failure to remit use tax on several purchases made during the audit period. "If a person incurs, upon examination by the department, a deficiency that is due to negligence, the person is subject to a penalty." Ind. Code § 6-8.1-10-2.1(a)(3). The penalty is ten percent (10%) of "the amount of the deficiency as finally determined by the department." Ind. Code § 6-8.1-10-2.1(b)(4). Negligence is defined in the Administrative Code as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations." Ind. Admin. Code tit. 45, r. 15-11-2(b).

Provision is made for the waiver of the ten percent (10%) penalty:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Ind. Admin. Code tit. 45, r. 15-11-2(c).

The taxpayer has failed to affirmatively show reasonable cause for not remitting the tax due. The penalty in this case is proper.

FINDING

The taxpayer's protest is denied.